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No. 98-272

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

NORFOLK SOUTHERN CORPORATION,
and affiliated companies, *et al.*,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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PETITIONERS' REPLY BRIEF

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Respondent's Brief opposes review but does not dispute the fact that this case involves a recurring issue with continuing economic importance to the entire container leasing industry, impacts the U.S. role in international trade, and, if not considered by the Court at this time, will result in a long period of financial exposure for the industry as cases pending in the Tax Court are litigated in three other circuit courts. *Pet.* at 7-8; *Amicus (IICL)* at 2.[1]

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[1] In an artfully worded but misleading footnote, respondent states that the statutory provisions "involved in this case" were repealed in 1986. *Resp.* at 3, n.2. But respondent fails to note that in that year Congress re-enacted the Container Provision as § 168(g)(4)(E) of the Internal Revenue Code of 1986—and that this case thus directly affects the tax benefits for containers for all years up to the present, and indefinitely into the future. *See Pet.*

Respondents' Brief portrays the Commisioner as acting fairly and reasonably and suggests that the taxpayers (together with the entire container industry) ignored a record-keeping requirement communicated to them by the Commissioner prior to the issuance of Rev. Rul. 90-9. In fact, the record in this case demonstrates precisely the opposite. In 1990, nearly 30 years after the enactment of the Container Provision and the adoption by the Commissioner of his regulation thereunder, and nearly eight years after closing a prior revenue ruling project on this issue,[2] the Commissioner promulgated a new retroactive "actual use" test that the Commissioner admitted, at the time he promulgated his ruling, could not practicably be complied with by any company in the industry—not just for the past but for the future as well. The Commissioner's action was a "case study in the abusive administration of the tax laws," and its approval by the courts below "underscores the inadequacy of the current standards for judicial review [of the Commissioner's duties under IRC § 7805(b)] and highlights the need for judicial refinement of those standards." *Amicus (Tax Foundation)* at 2.

I. THE PLAIN LANGUAGE OF THE CONTAINER PROVISION DOES NOT IMPOSE AN "ACTUAL USE" TEST FOR CONTAINERS.

Petitioners, like the rest of the container industry, treated containers as "used in the transportation of property to and from the United States" when the containers

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at 2, n.1. This case involves "an extremely important issue to the industry." *Amicus (IICL)* at 2.

[2] Respondent's Brief asserts without record citation that "the ruling project was not concluded in 1982" (*Resp.* at 13). But the Tax Court's findings of fact clearly state that the ruling project "was *closed* in 1982 without the publication of a revenue ruling"—after the Commissioner was specifically apprised of the facts relating to the container industry by the industry trade association (the IICL). *Pet. App.* at 33a (emphasis added).

were certified by international authorities for such use and committed to a fleet of containers made available for such use throughout the world. Petitioners were not required to trace the "actual use" of individual containers—fungible items of property without logs or fixed routes—because:

—no requirement of actual use appears in the Container Provision or its legislative history in 1962, nor in the regulation issued thereunder by the Commissioner in 1963;

—in direct contrast to the Commissioner's regulation under the Container Provision, other IRS regulations *do* contain such a requirement; and

—at the time of the transaction in this case, the Container Provision had been administered by the Commissioner for decades throughout the industry without the imposition of an actual use test.

The Commissioner argues that the "plain language" of the Container Provision requires that taxpayers prove that fungible items of property "touched" the United States, and that the containers did so within an arbitrary period of time nowhere specified in the Container Provision or the regulation thereunder. *Resp.* at 13. But the Container Provision plainly does *not* refer to containers *"actually* used in the *direct* transportation of property to and from the United States *by the end of the taxable year"* —since none of the italicized words appears in the Container Provision, its legislative history, or the IRS regulation issued thereunder. Instead, Congress referred to containers "*used* in the transportation of property to and from the United States"—at the same time that Congress (in another portion of the same 1962 legislation) referred to "the *use* of property *actually used*" for a specified activity. *Pet.* at 4, n.3.[3]

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[3] Respondent erroneously asserts that petitioners rely on statutory provisions and committee reports "under a different statute." *Resp.* at 9, n.6. In fact, all of petitioners' references were to a single

Significantly, respon dent has not cited, and cannot cite, a single federal i ncome tax case in which the word "used" has been held to mean "actually used." On the contrary, the case law as of 1962—when Congress enacted the Container P rovision—uniformly held that the term "used" was not re stricted to "actual use," and subsequent case law has un iformly held that the term "used" means "available for use." *See, e.g., Sears Oil Co. v. Commissioner,* 359 F.2d 191 (2d Cir. 1996).[4]

Respondent asserts that the Aircraft Provision (IRC § 48(a)(2)(B)(i) (1962)) and the Motor Vehicle Provision (IRC § 48(a)(2)(B)(iv) (1962)) support a U.S. touching requirement for containers. But with respect to both of those provisions, the legislative history expressly provided for a U.S. "touching" test—in direct contrast to containers (and vessels), where no such provision was made.[5] The Aircraft and Motor Vehicle sections thus do

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to the Internal Revenue Code made in the statute—the amendments t Revenue Act of 1962.

at the case law in existence in 1962 did

[4] Respondent argues tha word 'used' in every context" and instead "not purport to define the es such as "used in a trade or business." dealt with statutory phras precise issue in those cases was whether *Resp.* at 10, n.7. But the rade or business" if it was not "actually property was "used in a t nd the legislative history of the Revenue used" in that business—anr that Congress understood the need to Act of 1962 makes it clea hat was Congress' intent. Indeed, it was specify actual use where t erted in all of the pre-1962 cases that the the Commissioner who ass cted to "actual use." term "used" was not restri regarding aircraft and motor vehicles

[5] The legislative history the property had to return to the United specifically provided that t of frequency. H. Rep. No. 1447, 87th States with some degree 2), *reprinted in* 1963-3 C.B. at 517. The Cong., 2d Sess. A20 (1962 spect to containers and vessels included legislative history with re pite the Commissioner's current conten no such requirement—des of 1962 imposed an overriding "invest tion that the Revenue Act t. The Commissioner has never imposed ment at home" requiremen ent for vessels under IRC § 48(a)(2)(B) a U.S. "touching" requirem 9-509, 1969-2 C.B. 3 (vessel used exclu (iii) (1962). Rev. Rul. 6 s qualifies.) The Commissioner's "invest sively outside United State

not support respondent's "plain meaning" argument. On the contrary, they further demonstrate that Congress knew how to specify an actual use test if Congress intended to impose one.

The Commissioner ignores the fact that, in the Revenue Act of 1962, Congress enacted three other sections that referred to "actual use" in the text or legislative history, and in the same legislation referred to a U.S. "touching" test for aircraft and motor vehicles in the legislative history of the sections immediately surrounding the Container Provision. But Congress made no such references with respect to containers.

Rather than looking for a putative "plain meaning" of the Container Provision, the Court should "consider how the statutory provision at issue coheres with the general structure of the statute, since other provisions in the statute might shed light on the one being interpreted." Eskridge, Jr. and Frickey, "Statutory Interpretation as Practical Reasoning," 42 Stanford L. Rev. 321, 355 (1990);[6] *see* Barkan, "New Challenges to Use of the Plain Meaning Rule to Construe the IRC and Regs," Tax Notes, December 11, 1995 at 1403. The Container Provision should be interpreted in light of the vocabulary Congress used in 1962 and Congress' demonstrated awareness in the 1962 legislation of the distinction between "use" and "actual use."

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ment at home" theory is an egregious misreading of the legislative history. *See Pet.* at 12, n.9.

[6] Respondent's brief has no response to the fact that the Commissioner's actual use test produces results that are both irrational and arbitrary. *See* Pet. at 14, nn.13-14. *See also Commissioner v. Brown*, 380 U.S. 563, 575 (1965) (the "Commissioner's definition . . . would have wide ramifications which we are not prepared to visit upon taxpayers, without Congressional guidance").

II. THE COMMISSIONER ABUSED HIS DISCRETION BY ADOPTING AN "ACTUAL USE" REQUIREMENT IN 1990 AND APPLYING IT RETROACTIVELY TO 1981.

The second issue in this case is whether—regardless of the answer to the first issue—it was an abuse of discretion for the Commissioner to impose an actual use requirement retroactively, long after the industry had invested hundreds of millions of dollars in containers, and eight years after the Commissioner closed a prior ruling project, where the Commissioner admits, *at the time he imposes the requirement*, that it is impracticable for the industry to comply with it—not just for the past, but for the future as well.

The Commissioner's position is that there can *never* be an issue of retroactivity with respect to his rulings, because they do "no more than state his understanding of what the law has always meant" and thus are "no more retroactive . . . than is a judicial determination construing and applying a statute to a case in hand" (*Resp.* at 13). But the courts have held that the Commissioner has an obligation to apply the laws in a consistent and reasonable manner, *see Dixon v. United States*, 381 U.S. 68, 77, n.9, and this Court has recognized that the obligation is "independent . . . [of] whether we should hold as an original matter that the position the Commissioner now seeks to sustain is wrong." *United States v. Kaiser*, 363 U.S. 299, 308 (1960) (Frankfurter, J., concurring); *Dixon v. United States*, *supra* at 77, n.9; *see Amicus* (*Tax Foundation*) at 4 and 4, n.4.

If the correctness of a revenue ruling were a sufficient answer to a claim of abusive retroactive treatment, there could never be such a claim. The only issue would be the correctness of the ruling. But IRC § 7805(b) recognizes that the Commissioner has duties beyond simply interpreting the law correctly. The Commissioner also has a duty to treat taxpayers fairly and consistently in the application of the law.

In the present case, the Commissioner adopted a new rule in 1990 and applied it retroactively, despite knowing it had not been applied in innumerable prior audits, that an entire industry could not practicably comply with it, and that direct competitors would be affected differently for the past, depending on which prior years were still open. The Commissioner asserts it was "reasonable" under these circumstances to simultaneously announce an admittedly "impracticable" requirement for all open years and offer taxpayers (1) a 50% allowance if they agreed to accept it, or (2) a 0% allowance if they did not. The Commissioner paints this as a "safe-harbor percentage" (*Resp.* at 15), but in fact it was a bludgeon intended to force the industry to forgo 50% of the benefits intended by Congress.

Respondent's brief never mentions IRC § 7805(b) nor the obligation of the Commissioner thereunder to act reasonably in the retroactive application of new rulings and regulations. Instead, the Commissioner cites cases where IRC § 7805(b) was not involved. *Manhattan General Equipment Co. v. Commissioner,* 297 U.S. 129 (1936), involved a tax year prior to the enactment of § 7805(b) or its predecessor. Both *Helvering v. Hallock,* 309 U.S. 106 (1940), and *Dickman v. Commissioner,* 465 U.S. 330, 343 (1984) involved estoppel, not the Commissioner's duty of consistency and fairness under § 7805(b), and *Automobile Club of Michigan v. Commissioner,* 353 U.S. 180 (1957) explicitly recognizes the distinction between estoppel and abuse of discretion under § 7805(b). *Dixon v. United States,* 381 U.S. 68 (1965), relied upon by the Commissioner, in fact cites Justice Frankfurter's concurring opinion in *United States v. Kaiser, supra,* for the principle that the Commissioner's inconsistency can be an independent ground of decision, and cites *Automobile Club* for the proposition that "all the circumstances of the particular case" must be examined to determine whether an abuse of discretion occurred under § 7805(b). 381 U.S. at 77, n.9 and 76.

It is one thing to recognize that the Commissioner is not under a duty to assert a particular position as soon as the statute authorizes such an interpretation. *Resp.* at 13. It is another thing entirely for the Commissioner to adopt a new position 28 years after the statute was enacted, 27 years after promulgating a regulation that contains no actual use test, decades after multiple contrary audits of major companies, eight years after closing a two-year revenue ruling project—and then apply the new position retroactively for *nine years* in the present case (and with respect to tax years back to 1974 in other cases), knowing that no company in the industry can practicably comply with it. If such action does not violate the Commissioner's duty of consistency and fair dealing, it is difficult to imagine what would.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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